Interim Consolidated Financial Statements of

PARAGON PHARMACIES LIMITED

For the three and nine months ended May 31, 2011

Notice to Reader

The attached unaudited interim consolidated financial statements have been prepared by management of Paragon Pharmacies Limited and have not been reviewed by the Company's independent external auditors.

PARAGON PHARMACIES LIMITED

Interim Consolidated Statements of Operations, Comprehensive Loss and Deficit

(in thousands of Canadian dollars except per share amounts)
(Unaudited)

	Three months ended May 31		Nine months ended May 31	
	2011	2010	**2011**	2010
Revenue	**$ 19,096**	$ 21,025	**$ 58,865**	$ 62,903
Cost of sales	**11,810**	12,975	**36,077**	39,469
Operating expenses	**5,655**	5,899	**16,765**	17,263
	1,631	2,151	**6,023**	6,171
Corporate and other costs	**1,193**	1,261	**3,970**	3,244
Income before undernoted items	**438**	890	**2,053**	2,927
Amortization	**1,377**	1,298	**4,072**	3,737
Interest expense (Note 8)	**191**	198	**613**	714
Stock-based compensation (Note 7)	**17**	1	**20**	2
Other items	**1**	(23)	**(99)**	5
	1,586	1,474	**4,606**	4,458
Loss and comprehensive loss for the period	**(1,148)**	(584)	**(2,553)**	(1,531)
Deficit, beginning of period	**(29,586)**	(26,534)	**(28,181)**	(25,587)
Deficit, end of period	**$ (30,734)**	$ (27,118)	**$ (30,734)**	$ (27,118)
Loss per share (Note 10)				
Basic and diluted	**$ (0.01)**	$ (0.01)	**$ (0.03)**	$ (0.02)

See accompanying notes to the interim consolidated financial statements

PARAGON PHARMACIES LIMITED

Interim Consolidated Balance Sheets

(in thousands of Canadian dollars)
(Unaudited)

		May 31, 2011		August 31, 2010
Assets				
Current				
Cash and cash equivalents	**$**	**2,414**	$	4,285
Accounts receivable		**4,332**		4,889
Inventory		**8,755**		8,921
Prepaid expenses and deposits		**444**		643
		15,945		18,738
Capital assets		**6,774**		6,386
Intangible assets		**4,337**		6,922
Goodwill		**15,103**		15,103
	$	**42,159**	$	47,149
Liabilities				
Current				
Accounts payable and accrued liabilities	**$**	**8,690**	$	8,953
Current portion of long-term debt (Note 6)		**940**		936
Current portion of deferred rent inducements		**91**		91
Current portion of capital leases		**-**		16
		9,721		9,996
Long-term debt (Note 6)		**6,175**		7,008
Deferred rent inducements		**554**		622
Other long-term liabilities (Note 7)		**2**		-
		16,452		17,626
Shareholders' Equity				
Share capital (Note 7)		**51,572**		54,010
Contributed surplus (Note 7)		**4,869**		3,694
Deficit		**(30,734)**		(28,181)
		25,707		29,523
	$	**42,159**	$	47,149

Contingencies (Note 13)

See accompanying notes to the interim consolidated financial statements

PARAGON PHARMACIES LIMITED

Interim Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)
(Unaudited)

	Three months ended May 31		Nine months ended May 31	
	2011	2010	**2011**	2010
Operating activities				
Loss and comprehensive loss for the period	**$ (1,148)**	$ (584)	**$ (2,553)**	$ (1,531)
Items not affecting cash:				
Amortization	**1,377**	1,298	**4,072**	3,737
Interest expense (Note 8)	**34**	26	**100**	180
(Gain) loss on disposal of capital assets	**(1)**	-	**(100)**	28
Stock-based compensation	**17**	1	**20**	2
	279	741	**1,539**	2,416
Net change in non-cash working capital	**1,836**	552	**591**	(1,282)
	2,115	1,293	**2,130**	1,134
Financing activities				
Repayment of long-term debt	**(268)**	(9,729)	**(999)**	(10,918)
Share purchase under normal course issuer bid	**(455)**	(498)	**(1,281)**	(1,132)
Proceeds on issuance of long-term debt	**20**	5,000	**83**	5,000
Financing costs	**-**	(178)	**(13)**	(182)
Repayment of capital leases, net	**(4)**	(6)	**(16)**	(41)
	(707)	(5,411)	**(2,226)**	(7,273)
Investing activities				
Purchase of capital assets	**(635)**	(220)	**(1,841)**	(1,285)
(Addition) reduction to intangible assets	**(34)**	28	**(222)**	(633)
Proceeds on disposal of capital assets	**87**	-	**288**	22
	(582)	(192)	**(1,775)**	(1,896)
Increase (decrease) in cash and cash equivalents	**826**	(4,310)	**(1,871)**	(8,035)
Cash and cash equivalents, beginning of period	**1,588**	11,255	**4,285**	14,980
Cash and cash equivalents, end of period	**$ 2,414**	$ 6,945	**$ 2,414**	$ 6,945
Supplemental cash flow disclosure:				
Interest paid	**$ 82**	$ 116	**$ 292**	$ 378
Income taxes paid	**-**	-	**-**	-

See accompanying notes to the interim consolidated financial statements

1. NATURE OF OPERATIONS

Paragon Pharmacies Ltd. (the "Company" or "Paragon") was incorporated on August 1, 2002 under the Alberta Business Corporations Act and commenced active operations in March 2003. On October 31, 2006, the Company completed a reverse takeover transaction to create a new company, Paragon Pharmacies Limited. The Company is comprised of a single operating segment, pharmacy operations, providing retail and institutional prescription drug services and retail front store operations including supplemental services such as Canada Post outlets.

2. SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and follow the same accounting policies and methods of application with those used in preparation of the audited annual consolidated financial statements for the year ended August 31, 2010, except as described in note 3 under Changes in Significant Accounting Policies. Certain information and disclosures included in the year end consolidated financial statements have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended August 31, 2010.

In preparing interim consolidated financial statements in conformity with Canadian GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the interim consolidated financial statements and the reported amounts of revenue and expenses during the reporting period presented. Actual results could differ from these estimates.

3. CHANGES IN SIGNIFICANT ACCOUNTING POLICIES

Business combinations and consolidated financial statements

In January 2009, the Canadian Institute of Chartered Accountants ("CICA") issued new accounting standards concerning Business Combinations and Consolidated Financial Statements which is based on International Financial Reporting Standard ("IFRS") 3 and International Accounting Standard ("IAS") 27. The new sections replace existing guidance on accounting for business combinations, the preparation of consolidated financial statements and accounting for non-controlling interests. The standards are effective for fiscal years beginning on or after January 1, 2011, however earlier adoption is permitted. The Company adopted these standards on September 1, 2010 and has concluded there is no material impact on its consolidated financial statements.

4. FUTURE ACCOUNTING STANDARDS

International Financial Reporting Standards (IFRS)

In February 2008, the Accounting Standards Board ("AcSB") of Canada confirmed that International Financial Reporting Standards will replace Canadian GAAP for Canadian publically accountable enterprises effective for fiscal years beginning on or after January 1, 2011. The Company will implement these standards on September 1, 2011.

In accordance with IFRS, the Company will be required to report its results commencing with its fiscal year ending August 31, 2012, with the quarter ending November 30, 2011 being the first set of consolidated financial statements prepared under IFRS. Comparative figures for the quarter ending November 30, 2010 and year ended August 31, 2011 also need to be restated and presented in accordance with IFRS, including an opening balance sheet as at September 1, 2010 reconciled from current Canadian GAAP to IFRS. For the year ended August 31, 2011 and comparative year ended August 31, 2010, the Company will continue to report its results in accordance with Canadian GAAP.

5. ACQUISITIONS

On October 28, 2009, the Company acquired the prescription file of a pharmacy in Calgary, Alberta for total cash consideration of $0.84 million. The cash cost of the acquisition was allocated to intangible assets prescription files on the basis of the fair value acquired. The acquisition agreement provided for an up-front cash payment of $0.50 million and an additional payment in November 2010 dependent on the volume of prescriptions at the store which was the primary beneficiary of this transaction for the twelve month period ended October 29, 2010. Based on the actual prescription volumes during this period the Company made the remaining payment of $0.34 million, of which $0.32 million was accrued at August 31, 2010, and subsequently paid to the vendor in the first quarter of fiscal 2011.

(All amounts in thousands, except per share amounts)

6. LONG-TERM DEBT AND BANK INDEBTEDNESS

		May 31, 2011		August 31, 2010
Canadian Imperial Bank of Commerce Term loan, net of $0.14 million financing costs (August 31, 2010 - $0.19), bearing interest at prime plus 1% to prime plus 2% per annum depending on Company specific covenants, repayable in quarterly installments of $0.25 million plus interest, due April 8, 2013.	**$**	**3,858**	$	4,562
Autonomy Loan Loan payable, net of financing costs of $0.36 million (August 31, 2010 - $0.40 million), unsecured and repayable over a ten year period ending September 30, 2017. Interest accrues at the rate of 6% per annum, payable annually on August 31st of each year.		**3,188**		3,363
Other long-term debt Various obligations bearing interest between 0.0% and 6.4%, secured by general security agreements, general assignments of book debts, due between September 2013 and November 2015.		**69**		19
		7,115		7,944
Less current portion		**940**		936
	$	**6,175**	$	7,008

On April 6, 2010, the Company secured a three year credit facility with a $5.0 million operating line, $5.0 million term loan and a $15.0 million acquisition facility. Interest rates on the credit facility are set at prime plus 1% to prime plus 2% which is adjusted every quarter dependent on Company specific covenants outlined in the agreement. The term loan is payable in quarterly principal installments amortized over 5 years from advance date. Advances under the acquisition facility are payable in quarterly principal installments amortized over 5 years from each advance date. The facility is to be refinanced on or before April 8, 2013.

(All amounts in thousands, except per share amounts)

6. LONG-TERM DEBT AND BANK INDEBTEDNESS *(continued)*

Subsequent to the end of the quarter, the Company amended the credit facility to increase the term loan to $5.8 million from the original $5.0 million. The amended term loan still bears interest at prime plus 1% to prime plus 2% per annum depending on Company specific covenants and is due April 8, 2013. Quarterly installment payments will increase to $0.3 million plus interest to cover the additional $0.8 million advanced under the term loan subsequent to the end of the quarter. The operating line and acquisition facility have remained unchanged under the Company's amended credit facility.

The facility is secured by a general security agreement representing a first charge on all the assets and undertakings of the Company and its subsidiaries, unlimited guarantees of advances by the Company and its subsidiaries, subordination/priority agreements with a certain supplier and an assignment of fire insurance over assets of the Company and its subsidiaries.

At May 31, 2011, the Company had issued letters of credit aggregating $0.5 million (August 31, 2010 - $0.5 million) leaving $4.5 million (August 31, 2010 - $4.5 million) of the $5.0 million (August 31, 2010 - $5.0 million) operating facility available.

Scheduled principal repayments to maturity, excluding the Autonomy Loan, for the period ending May 31 are as follows:

2012	$	940
2013		2,954
2014		16
2015		11
2016		6
Total	$	3,927

The Autonomy Loan is repayable in variable amounts annually with total repayment to occur no later than September 30, 2017.

(All amounts in thousands, except per share amounts)

7. SHARE CAPITAL

Authorized
Unlimited number of common voting shares
Unlimited number of first and second preferred shares,
issuable in series, rights to be determined by directors

	Number of Common Shares Issued		Share Capital
Balance, August 31, 2009	97,606	$	56,589
Purchased through normal course issuer bid and subsequently cancelled	(4,271)		(2,579)
Balance, August 31, 2010	93,335		54,010
Purchased through normal course issuer bid and subsequently cancelled	(4,358)		(2,438)
Balance, May 31, 2011	**88,977**	**$**	**51,572**

Normal course issuer bid

On October 8, 2009, the Company announced its intention to make a Normal Course Issuer Bid ("NCIB") to purchase for cancellation up to a maximum of 4,880,319 shares. The NCIB commenced on October 9, 2009 and terminated on October 8, 2010. On October 8, 2010, the Company received approval for the renewal of the NCIB which allows the Company to purchase up to an additional 4,637,794 common shares until the renewed NCIB expires on October 11, 2011.

For the nine month period ended May 31, 2011, 4.051 million (year ended August 31, 2010 – 4.578 million) common shares have been purchased for cash consideration of $1.281 million (August 31, 2010 - $1.421 million) or approximately $0.32 (August 31, 2010 - $0.31) per common share. During the nine month period ended May 31, 2011, 4.358 million (year ended August 31, 2010 – 4.271 million) common shares were cancelled resulting in a reduction in share capital of $2.438 million (August 31, 2010 – 2.579 million) and an increase in contributed surplus of $1.157 million (August 31, 2010 - $1.122 million) representing the consideration deficiency to stated capital.

For the period June 1, 2011 to July 19, 2011, the Company has not purchased any shares under the Company's NCIB. All shares purchased under the Company's NCIB prior to May 31, 2011 were cancelled at May 31, 2011.

(All amounts in thousands, except per share amounts)

7. SHARE CAPITAL *(continued)*

Share unit plan

On April 22, 2010, the Company adopted a Share Unit Plan where up to 2.0 million common shares may be issued as Unit Awards and designated as restricted for performance awards. Each common share fair market value will be calculated using the weighted average of the common shares traded on the TSX Venture Exchange for ninety calendar days immediately preceding such date. Each Unit Award granted shall be subject to the terms and conditions of the Share Unit Plan, and be subject to the requirements of the TSX Venture Exchange. Under the terms of the Share Unit Plan, participants are eligible to receive common shares or an equivalent cash value of common shares. For Unit Awards granted for a prior service period, the compensation cost will be recognized in the period the Unit Award is granted. In the case of Unit Awards granted for current or future service periods, the fair value of the grant is based on the intrinsic value of the units and compensation cost is recognized over the expected service period of the stock-based compensation. In the event the service period is not defined, treatment will be consistent with Unit Awards granted for current and future periods. Changes in the amount of the liability due to share price changes are recognized as stock-based compensation expense in the period in which the changes occur.

Restricted Share Units ("RSUs")	Nine months ended May 31, 2011
Outstanding, beginning of period	-
Issued	72,414
Exercised	-
Outstanding, end of period	72,414
Exercisable, end of period	-

During the three and nine months ended May 31, 2011, the Company issued Nil and 72,414 RSUs, respectively. Compensation expense related to these units recognized during the three and nine months ended May 31, 2011 was $0.002 million and $0.002 million respectively. The RSUs outstanding at May 31, 2011 vest on December 9, 2013.

(All amounts in thousands, except per share amounts)

7. SHARE CAPITAL *(continued)*

Stock-based compensation

The Company has an incentive stock option plan for certain employees, officers and directors. Compensation expense for stock options is recognized using the estimated fair value at the time the options are granted and is amortized over the vesting period of the related option. The total number of common shares reserved for issuance under the stock option plan shall not exceed 2,669,321, as at May 31, 2011, calculated as 3% of the issued and outstanding common shares of the Company. As at May 31, 2011, 1,912,826 (August 31, 2010 – 2,478,379) common shares remain reserved for issuance under the stock option plan.

The continuity of the Company's outstanding and exercisable options is as follows:

	Nine months ended May 31, 2011		Year ended August 31, 2010	
	Number of Options Outstanding	**Weighted average exercise price**	Number of Options Outstanding	Weighted average exercise price
Outstanding, beginning of period	**322**	**$ 0.41**	627	$ 0.60
Issued	**445**	**0.29**	-	-
Exercised	**-**	**-**	-	-
Expired	**(10)**	**0.45**	(305)	0.78
Outstanding, end of period	**757**	**$ 0.34**	322	$ 0.41
Exercisable, end of period	**312**	**$ 0.41**	322	$ 0.41

The following table summarizes information about stock options outstanding and exercisable at May 31, 2011:

Date Issued	Number of Options Outstanding	Number of Options Vested	Exercise Price	Expiry Date
May 28, 2008	262	262	$ 0.45	May 28, 2013
October 21, 2008	50	50	$ 0.21	October 21, 2013
February 11, 2011	145	-	$ 0.29	December 9, 2015
February 11, 2011	300	-	$ 0.29	February 11, 2016
Total	757	312		

(All amounts in thousands, except per share amounts)

7. SHARE CAPITAL *(continued)*

During the three and nine months ended May 31, 2011, $0.015 million and $0.018 million (May 31, 2010 – $0.001 million and $0.002 million) was recognized as stock-based compensation expense related to options with a corresponding increase to contributed surplus.

The weighted average fair value of the options issued during the nine months ended May 31, 2011 was $0.25 per share purchase option as determined using the Black-Scholes option pricing model. The following weighted average assumptions were utilized to calculate the fair value:

	Nine months ended May 31, 2011
Total options granted	445
Weighted average exercise price	$ 0.29
Risk-free interest rate	2.76 %
Expected life	4.95 years
Vesting period	3.91 years
Expected annual volatility	133 %
Expected dividend yield	nil

Contributed surplus arises from the following:

	Nine months ended May 31, 2011	Year ended August 31, 2010
Balance, beginning of period	**$ 3,694**	$ 2,570
Cancellation of purchased shares	**1,157**	1,122
Stock-based compensation	**18**	2
Balance, end of period	**$ 4,869**	$ 3,694

(All amounts in thousands, except per share amounts)

8. INTEREST EXPENSE

	Three months ended May 31		Nine months ended May 31	
	2011	2010	**2011**	2010
Amortization of financing costs	**$ 34**	$ 26	**$ 100**	$ 180
Bank charges and interest	**19**	51	**77**	116
Interest on long-term debt	**140**	125	**446**	440
Interest income	**(2)**	(4)	**(10)**	(22)
	$ 191	$ 198	**$ 613**	$ 714

9. INCOME TAXES

	Nine months ended May 31, 2011	Nine months ended May 31, 2010
Net loss for the period	**$ (2,553)**	$ (1,531)
Computed income tax expense at statutory rate of 27.72% (2010 – 30.44%)	**(708)**	(466)
Stock-based compensation	**6**	1
Other permanent differences	**59**	227
Impact of future tax rate differences	**40**	(9)
Change in valuation allowance	**603**	247
	$ -	$ -

Subject to confirmation by income tax authorities, the Company has approximately the following tax amounts available for future deduction:

	As at May 31, 2011	As at August 31, 2010
Undepreciated capital cost	**$ 6,233**	$ 5,687
Cumulative eligible capital	**16,111**	16,999
Share issue costs and financing costs carried forward	**1,432**	2,329
Non-capital losses carried forward for tax purposes with expiration dates between 2013 and 2030	**15,322**	13,524
	$ 39,098	$ 38,539

(All amounts in thousands, except per share amounts)

9. INCOME TAXES *(continued)*

These amounts are deductible from future income at rates prescribed by the Canadian Income Tax Act. The components of the Company's future income tax liability (asset) are a result of the origination and reversal of temporary differences and are comprised of the following:

Nature of temporary differences	**As at May 31, 2011**	As at August 31, 2010
Capital assets	**$ 196**	$ 310
Intangible assets	**(1,586)**	(1,253)
Goodwill	**795**	698
Rebranding	**11**	19
Deferred rent inducement	**(166)**	(183)
Capital leases	**-**	(4)
Share issue costs and financing costs	**(252)**	(449)
Non-capital tax losses carry forward	**(3,939)**	(3,476)
	(4,941)	(4,338)
Valuation allowance	**4,941**	4,338
Future income tax liability (asset)	**$ -**	$ -

10. PER SHARE AMOUNTS

	Three months ended May 31		Nine months ended May 31	
	2011	2010	**2011**	2010
Weighted average number of shares				
Basic	**89,675**	95,549	**91,366**	96,669
Diluted	**89,675**	95,549	**91,366**	96,669

Diluted earnings per share have been calculated using the treasury stock method and includes the dilutive effect, if any, of options.

11. RELATED PARTY TRANSACTIONS

Canterbury Park Management Inc. provides management services as a shareholder. Under the current agreement, the Company pays $0.20 million a year for advisory services. In the prior year, in addition to the $0.20 million a year for advisory services, the agreement also provided for $0.03 million a month for executive services. During the three and nine month periods ended May 31, 2011, the Company expensed $0.05 million and $0.15 million (May 31, 2010 - $0.10 million and $0.33 million) for advisory and executive services provided by Canterbury Park Management Inc.

The Company also paid $0.05 million and $0.15 million, respectively, for the three and nine month periods ended May 31, 2011 (May 31, 2010 - $0.05 million and $0.14 million) in rent for premises leased under operating leases with parties related by virtue of common management and directors. These transactions are in the normal course of operations and have been recorded at the exchange amount, which is the amount agreed to by the related parties.

12. CAPITAL MANAGEMENT

The Company's primary objectives when managing capital are to profitably grow its business while maintaining adequate financing flexibility to fund new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an appropriate rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and features, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology. The Company largely relies on its cash flow from operations to fund its capital investment program supplemented by debt and equity offerings. No changes were made to these objectives during the period.

The Company considers its total capitalization to be long-term debt (including the current portion thereof) and shareholders' equity, net of cash. The Company also gives consideration to its obligations under capital leases when assessing its total capitalization. As at May 31, 2011, the Company believes it has available cash resources, comprised of cash and cash equivalents and availability of long-term debt, to make necessary capital investments and to fund acquisitions. The Company may require additional debt and/or equity capital to fund any significant opportunities.

(All amounts in thousands, except per share amounts)

12. CAPITAL MANAGEMENT *(continued)*

The Company monitors its capital structure principally through measuring its net debt to shareholders' equity and net debt to capitalization ratios, and manages its ability to service its debt and meet other fixed obligations by tracking its interest and other fixed charges coverage ratios.

As part of its lending agreement, the Company monitors its net senior debt to EBITDA ratio as defined in its lending agreement. At May 31, 2011, and for the three and nine month periods then ended the Company is in compliance with its bank covenants.

The following table provides a summary of certain information with respect to the Company's capital structure and financial position at the end of the period.

	As at May 31, 2011	As at August 31, 2010
Cash and cash equivalents	**$ (2,414)**	$ (4,285)
Current portion of long-term debt and capital leases	**940**	952
Long-term debt	**6,175**	7,008
Net debt	**4,701**	3,675
Shareholders' equity	**25,707**	29,523
Total capitalization	**$ 30,408**	$ 33,198
Net debt: Shareholders' equity	**0.18**	0.12
Net debt: Total capitalization	**0.15**	0.11

13. CONTINGENCIES

On April 5, 2007 the Company was named as a defendant in a statement of claim filed by Katz Group Canada Inc., Drug Trading Company Ltd., Pharmx Rexall Drug Stores Ltd. and Katz Group Canada Ltd., as plaintiffs. Management of the Company believes that the allegations raised in the statement of claim are without merit and the Company intends to vigorously defend the action to the full extent permitted under law. Any loss will be recorded in the period the claim is resolved.

(All amounts in thousands, except per share amounts)

14. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.